

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA

DOCKET NO. 2018-318-E

In the Matter of)	REVISED
)	REBUTTAL TESTIMONY OF
Application of Duke Energy Progress, LLC for)	JOHN L. SULLIVAN, III
Adjustments in Electronic Rate Schedules And)	FOR DUKE ENERGY
Tariffs and Request for an Accounting Order)	PROGRESS, LLC

1 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND**
2 **CURRENT POSITION.**

3 A. My name is John L. Sullivan, III. My business address is 550 South Tryon
4 Street, Charlotte, North Carolina. I am employed by Duke Energy Business
5 Services, LLC as Director, Corporate Finance and Assistant Treasurer. I
6 am also the Assistant Treasurer of Duke Energy Progress, LLC (“DE
7 Progress” or the “Company”).

8 **Q. DID YOU PREVIOUSLY FILE DIRECT TESTIMONY AND**
9 **EXHIBITS IN THIS PROCEEDING?**

10 A. Yes, I did.

11 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

12 A. The purpose of my rebuttal testimony is to respond to portions of the
13 testimony filed by Mr. David Parcell, witness on behalf of the South
14 Carolina Office of Regulatory Staff (“ORS”).

15 First, I address Witness Parcell’s recommendation for the cost of
16 long-term debt. I will also address Witness Parcell’s recommended Return
17 on Equity (“ROE”) and the financial impacts to the Company from the
18 overall revenue requirement recommendation of the ORS.

19 **Q. PLEASE PROVIDE AN OVERVIEW OF YOUR TESTIMONY.**

20 A. First, the ORS proposes to use the 4.06% cost of debt as of December 31,
21 2017 originally filed in my direct testimony. This adoption is inconsistent
22 with the ORS’s proposal to update the cost of debt in Duke Energy
23 Carolinas, LLC’s (“DE Carolinas”) pending South Carolina rate case to

1 reflect 2018 long-term debt financing activity. I recommend using DE
2 Progress' updated 4.16% cost of debt calculated as of December 31, 2018.
3 The methodology we use in calculating this updated cost of debt is the same
4 we employed when updating the DE Carolinas cost of debt as of December
5 31, 2018.

6 I also examine the detrimental impacts to the Company of Witness
7 Parcell's recommended 9.30% ROE and the overall revenue requirement
8 proposed by the ORS. The ORS's recommendation does not take into
9 account the adverse impacts the reduced cash flows would have on credit
10 quality. These impacts could be severe, to the detriment of the Company's
11 credit quality and the interests of its customers. The Company's regulatory
12 capital structure and allowed ROE are key components in maintaining the
13 Company's current "A" credit ratings and its overall financial strength and
14 flexibility.

15 **Q. THE ORS ADOPTS THE 4.06% COST OF DEBT AS FILED BY THE**
16 **COMPANY. IS THIS CONSISTENT WITH THEIR POSITION IN**
17 **THE DE CAROLINAS RATE CASE?**

18 A. No. In the DE Carolinas rate case, Witness Parcell proposed the cost of
19 debt be reduced from 4.63% (as of December 31, 2017) to 4.44% (as of
20 December 31, 2018) to reflect certain long-term debt issuances in 2018. DE
21 Carolinas agreed to reflect the updated cost of debt as of December 31, 2018
22 but calculated a year-end rate of 4.53% to reflect Witness Parcell's update
23 for long-term debt issuances as well as all other changes to DE Carolinas

1 long-term debt profile – which is still 10 basis points lower than the
2 Company's original debt rate as of December 31, 2017. For consistency,
3 DE Progress recommends the cost of debt be updated to 4.16% to reflect all
4 long-term debt financing activity through year-end 2018. Please see
5 Sullivan Rebuttal Exhibit 1, which includes my updated cost of debt
6 calculation as of December 31, 2018.

7 **Q. WITNESS PARCELL'S ANALYSES ESTIMATED THE**
8 **COMPANY'S ROE TO BE IN A RANGE OF 9.10% TO 9.50%, WITH**
9 **A RECOMMENDED MID-POINT ESTIMATE OF 9.30%. HOW**
10 **DOES THIS COMPARE WITH COMPANY WITNESS ROBERT**
11 **HEVERT'S ROE RECOMMENDATION?**

12 A. Mr. Parcell's 9.30% ROE recommendation is 145 basis points below
13 Company Witness Hevert's recommended point estimate of 10.75%. In his
14 direct testimony, and maintained in his rebuttal testimony, Mr. Hevert
15 believes that an ROE in the range of 10.25% to 11.00%, with a point
16 estimate of 10.75% is commensurate with his quantitative and qualitative
17 analyses of DE Progress. As stated in my direct testimony, the Company
18 fully supports Witness Hevert's proposed ROE and analysis, yet offered a
19 25 basis point concession with rates being set in conjunction with a ROE of
20 10.50%. Approval of this request will allow the Company to maintain its
21 healthy credit profile, generate adequate cash flow to support its critical
22 capital investments, and fairly balance the needs of affordable electric rates
23 for customers and an acceptable ROE for equity investors.

1 **Q. WHEN DECIDING WHERE TO INVEST CAPITAL, DO**
2 **INVESTORS CONSIDER EACH UTILITY COMPANY'S**
3 **AUTHORIZED ROE?**

4 A. Yes. Just as the Company must compete for capital among fixed income
5 investors in the debt capital markets, it must also be well positioned against
6 its peers to attract equity capital. A pivotal factor in any investment decision
7 is the risk-return profile of the subject company. Authorized ROE is of
8 paramount importance because it drives a company's ability to earn a return
9 on invested capital and share that return with equity investors. If the
10 Commission were to adopt the ORS's recommended 9.30% it could
11 negatively impact DE Progress' ability to attract debt and equity capital on
12 reasonable terms, especially in times of financial stress or under volatile
13 market conditions.

14 **Q. HAVE YOU CONSIDERED AUTHORIZED ROES OF OTHER**
15 **COMPARABLE INVESTOR OWNED UTILITIES?**

16 A. Yes. In the table below, I compare the current authorized ROEs of vertically
17 integrated utilities located in the Southeastern United States.

Regulated Utility	State	Docket/Case No.	Year of Order	Current Authorized ROE
Georgia Power	GA	36989	2013	10.95% ⁽¹⁾
Entergy Mississippi	MS	2014-UN-0132	2014	10.07%
Florida Public Utilities Co.	FL	140025-EI	2014	10.25%
Florida Power & Light	FL	160021-EI	2016	10.55%
Kingsport Power Company	TN	16-00001	2016	9.85%
Virginia Electric and Power	NC	E-22, Sub 532	2016	9.90%
Duke Energy Florida	FL	20170183-EI	2017	10.50% ⁽²⁾
Gulf Power	FL	160186-EI	2017	10.25%
Tampa Electric Co.	FL	20170210-EI	2017	10.25%
Duke Energy Carolinas	NC	E-7, Sub 1146	2018	9.90%
Duke Energy Progress	NC	E-2, Sub 1142	2018	9.90%
South Carolina Electric & Gas	SC	2017-370-E	2018	9.90% ⁽³⁾
Average				10.19%

(1) Authorized retail ROE set under the 2013 Alternative Rate Plan approved by the Georgia Public Service Commission and evaluated against a range of 10.00% to 12.00%

(2) Represents the mid-point of an authorized range from 9.50% to 11.50%. ROE was originally authorized in the 2010 rate case (Docket No. 090079-EI) and re-authorized in a 2013 settlement and again in the 2017 settlement

(3) ROE is to be applied to the capital costs associated with the unrecovered balance of the VC Summer project regulatory asset. The commission actually determined the Cost of Equity to be 10.75%, but accepted SCE&G's proposal of 9.90% as part of the merger resolution.

1 **Q. WHAT DID YOUR REVIEW DETERMINE?**

2 A. When reviewing the authorized ROEs over the past 6 years of comparable
3 utility companies in the southeast, it is clear the Company's requested
4 10.50% ROE is in-line with the current authorized ROEs of its peers.
5 Witness Parcell's proposed ROE of 9.30% is 55 basis points below the
6 lowest authorized ROE shown in the table above. Investors and creditors
7 of DE Progress would see this as a significant departure from our peer group
8 and our current ROE and this would result in higher financing costs to the
9 Company.

1 **Q. MR. PARCELL’S RECOMMENDED ROE IS ONE PART OF THE**
2 **REVENUE REQUIREMENT RECOMMENDED BY THE ORS. DO**
3 **YOU HAVE ANY CONCERNS WITH THE OVERALL ORS**
4 **RECOMMENDATION?**

5 A. Mr. Parcell’s recommended ROE does not exist in isolation, but rather is
6 part of an overall recommendation by the ORS, summarized in Audit
7 Exhibit KLM-2. To fully understand the adverse impact to the Company’s
8 credit quality, the entire recommendation must be considered. Audit
9 Exhibit KLM-2 outlines a reduction of the current allowed ROE by 90 basis
10 points, disallowance of incurred costs, and extending the period of recovery
11 for other costs. Adopting the ORS position would exacerbate the magnitude
12 of regulatory lag cited by the rating agencies and weaken DE Progress’
13 credit metrics. On a quantitative basis, leverage would increase and cash
14 flows to fund operations and service debt would decrease. In particular, the
15 ORS’s recovery approach for coal ash remediation costs would place
16 downward pressure on credit metrics. In recent credit reports, both
17 Moody’s and S&P view the current DE Progress regulatory framework as a
18 generally constructive, supporting long-term credit quality. Adopting the
19 ORS position with a significantly lower ROE and reduced recovery for coal
20 ash remediation could weaken this view.

21 When considering a company’s credit rating, the rating agencies
22 contemplate both qualitative and quantitative components of a borrower’s
23 credit quality. Moving one component changes how a rating agency will

1 view other components. For example, if the agencies' qualitative
2 assessment of a company is lowered, they may then require stronger
3 quantitative metrics to offset the change in order to avoid a credit
4 downgrade. If the ORS's recommendations are adopted, it would have an
5 adverse impact on both the qualitative (less constructive regulatory
6 environment) and quantitative (weaker credit metrics) aspects in evaluating
7 DE Progress' credit quality, which would compromise its ability to
8 undertake investments designed to improve the customer experience.

9 **Q. GIVEN YOUR CONCERNS WITH HOW THE OVERALL ORS**
10 **RECOMMENDATION WILL ADVERSELY IMPACT CREDIT**
11 **QUALITY, HOW DO YOU BELIEVE FIXED INCOME**
12 **INVESTORS WILL REACT IF THE RECOMMENDATION WERE**
13 **TO BE ADOPTED?**

14 A. When evaluating investment alternatives, fixed income investors use a set
15 of criteria similar to that of the rating agencies. As previously stated, if the
16 ORS recommendation were to be adopted, DE Progress' leverage would
17 increase and cash flows would decrease. For a fixed income investor, the
18 risk of investing in DE Progress' debt securities would increase. In order
19 to compensate for the increased risk, investors would require a higher rate
20 of debt. This would increase the cost of future debt issuances.

21 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

22 A. Yes, it does.